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SENSITIVE

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TAGS: EFIN ECON ECIN RP CN XE XD
SUBJECT: Philippine First Quarter Growth Disappoints

REFS: A) Manila 0680, B) Manila 0796

SENSITIVE BUT UNCLASSIFIED

¶1. (U) Summary: Philippine Gross Domestic Product fell 2.3% from the fourth quarter of 2008, the weakest performance in two decades. Capital formation dropped; personal consumption sputtered; and the government's much trumpeted fiscal stimulus did little to support economic growth. In response, the Central Bank again cut interest rates and the government vowed to accelerate spending. Some analysts now warn of the possibility of a mild recession, although many still predict the economy will muster some growth this year and a financial crisis remains unlikely. The sobering performance has re-energized calls for reforms to address constraints to growth. End Summary.

First Quarter GDP Barely Up Year-on-Year

¶2. (U) Government data released on May 28 showed Philippine GDP up by barely 0.4% year-on-year. The sharpness of the growth slowdown surprised both government and private sector analysts. With economic expansion outpaced by population growth of around 2%, real per capita GDP declined by 1.5%, the first such decline since the third quarter of 2001. Seasonally adjusted GDP (which is estimated but lacks detail and is not published) declined 2.3% from the fourth quarter of 2008, the weakest performance in 20 years.

Consumers Tighten Belts, Investors Cautious

¶3. (U) On the demand side, private consumption expenditures grew only 0.8% year-on-year in real terms. Higher remittances by overseas workers pushed up first-quarter Gross National Product to 4.4% growth but appeared to have done little to buoy personal consumption. Capital formation slumped 16.5% from the first quarter of 2008 as investments in durable equipment dropped nearly 18% (the sharpest decline posted since the fourth quarter of 1998) and businesses pulled back from building up inventories. Total exports of goods and non-factor services contracted by 18.2% year-on-year in real peso terms, reflecting weak merchandise exports (down 30.5%) and tourism receipts (down 14.4%).

¶4. (U) On the production side, weak domestic and external demand resulted in a 2.1% year-on-year contraction in industrial sector output. This stemmed mainly from 7.3% and 1.1% declines, respectively, in manufacturing and public utilities. Services expanded by a lethargic 1.4% despite a relatively resilient business services subsector led by the business process outsourcing industry. Agriculture grew 2.1%.

Further Monetary Easing

¶5. (U) The Philippine Central Bank cut its borrowing (reverse repurchase) and lending (repurchase) rates by another 25 basis points on May 28. This represented the fifth rate cut since December 2008, totaling 1.75 percentage points thus far.

Stimulus and Fiscal Tightrope

¶6. (U) According to first quarter GDP data, government consumption grew 3.8% year-on-year but infrastructure investments contracted 4.4%. Total government consumption and infrastructure investments grew a modest 1.6% from the first quarter of 2008. According to Department of Budget and Management officials, cash disbursements for infrastructure/capital outlays expanded by more than 60% from the first quarter of 2008 but lags between cash releases and actual construction meant that the expected impact of fiscal stimulation would be more evident in succeeding quarters. The economy's weaker-than-expected performance has intensified pressures on the economic team to expand the 2009 fiscal deficit ceiling (currently 2.5% of GDP) as revenues faltered to prevent budget cuts that would jeopardize fiscal pump-priming goals (Ref A).

Prospects and Challenges

¶7. (SBU) During a meeting on May 28, an International Monetary Fund (IMF) economist told us that the IMF had expected that first-quarter growth would be 2.2%, and growth for the entire year 0%. He noted that the IMF prediction of zero growth for the year

had seemed pessimistic when it was first issued more than a month ago, but now seemed realistic and, perhaps, even optimistic. He added that some economists believed that Q1 would be the best quarter of 2009 based on the momentum the economy had at the end of 2008, but Q4 2008 growth has now been revised down to only 2.9%, and all 2008 down to 3.8%, showing that the economy was already slowing significantly at the end of last year.

¶8. (SBU) The IMF official added that most economists thought it would be appropriate for the Philippines to increase its government deficit to 3% of GDP to allow more spending. However, he cautioned that "ammunition" should also be saved for next year, so it would be better for the Philippines to have a 3% budget deficit this year and 3% next year rather than a 5% budget deficit this year and 1% next year. Economists have noted that there is little foreign interest in purchasing Philippine government debt, and that any further spike in risk aversion would divert more funds away from the Philippines and make it still harder to issue debt.

¶9. (SBU) A number of local economists have told us that unemployment of overseas workers will likely continue to go up in coming months, threatening remittances and potentially dampening economic growth further. Although expectations vary about overseas employment and remittance prospects, economists agree that what happens to overseas workers incomes will be a key factor in Philippine economic performance this year.

Complacency to Urgency

¶10. (U) The government publicly continues to express confidence that the Philippines will avoid a recession (defined in the Philippines as two consecutive quarters of negative year-on-year growth). The government and private sector both express optimism for increased growth in the second semester. Although a few now raise the possibility of a mild recession because of the disappointing first quarter growth performance, many local and foreign observers of the Philippine economy (including investment banks and rating agencies) still predict that 2009 domestic economic growth will avoid falling into negative territory.

¶11. (U) Still, there is broad concern about the global economic

environment and the first quarter growth numbers provided a sobering warning. The Joint Foreign Chambers of Commerce, in a press conference on June 1, renewed calls for the government to further open up the economy and address long-standing competitiveness issues that have stymied growth, investments, employment generation, and poverty alleviation -- a message echoed by major local chambers and donor agencies.

Kenney